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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1932.

No. 182

PINELLAS ICE AND COLD STORAGE COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

BRIEF FOR PETITIONER.

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Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on March 29, 1932 (R. 31). The Petition for certiorari was filed June 27, 1932. Certiorari was granted October 10, 1932. (R. 32.) Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

Question Presented.

Section 203 of the Revenue Act of 1926 provides that no gain or loss shall be recognized, so far as the corporation is concerned, when a corporation, a party to a reorganization, exchanges property for securities and cash received from another corporation, a party to the reorganization, and the proceeds are distributed in pursuance of the plan of reorganization.

A newly formed corporation acquired over 99 per cent of the assets of Petitioner, and, likewise, substantially all the assets of another corporation known as Citizens Ice & Cold Storage Company (hereinafter called "Citizens Company"). The acquisition of these two properties was in pursuance of a plan, worked out over a period of months, and two agreements, the carrying out of each of which was dependent upon the carrying out of the other. In other words, the new corporation acquired substantially all of the assets of two existing corporations, pursuant to a definite and mutually agreed plan. (R. 17-19.)

The Revenue Act of 1926 provides:

> "203 * * * (h) * * *(1) The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority

of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected."

The Circuit Court of Appeals held that the acquisition of substantially all of the properties of another corporation did not of itself constitute a reorganization within the meaning of the above statute.

This decision results in the imposition of two income taxes, one against the corporation and one against the stockholder. The question here presented is whether or not, under the Revenue Act of 1926, upon the transfer of all the assets of a corporation for cash and securities and the distribution of the proceeds, there is a double income tax, or whether there is only a single tax and that upon the stockholder, the ultimate beneficiary.

Statute Involved.

The Revenue Act of 1926 provides in part as follows:

"Sec. 203. * * * (b) * * * (3) No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * *

"(e) If an exchange would be within the provisions of paragraph (3) of subdivision (b) if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

"(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange,

* * *

"(h) As used in this section and sections 201 and 204—

"(1) The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

"(2) The term 'a party to a reorganization' includes a corporation resulting from a reorganization * * *."

(The Appendix contains Section 203 in its entirety.)

Statement.

This case is before this Court on writ of certiorari to the Circuit Court of Appeals for the Fifth Circuit (R. 32). The Circuit Court of Appeals affirmed (R. 31) the decision of the United States Board of Tax Appeals determining an additional income tax upon Petitioner for the calendar year 1926 (R. 24) as a result of recognizing gain to the Petitioner on the transaction herein next described.

Petitioner and Citizens Ice and Cold Storage Company were Florida corporations owned by substantially the same stockholders. "The Fitkin interests (National Public Service Corporation) desired to acquire the business of both companies, but were unwilling to consider the acquisition of one without the other. All the directors and stockholders of both companies were anxious to dispose of all the properties of the two companies, and upon the disposal of the properties to discontinue business, dissolve the corporations, and distribute the proceeds. * * * It was definitely understood and agreed by all of the stockholders and directors that upon the making of the transfer of the properties, the affairs of the two corporations would be wound up, the assets distributed to the stockholders in liquidation, and the corporations dissolved." (Findings of Fact, R. 13-14.)

Negotiations to bring about the transfer were commenced in February, 1926 and culminated in agreements that Petitioner and Citizens Company would transfer their operating properties, being 99% of Petitioner's assets, (Findings of Fact, R. 19) and substantially all of the assets of Citizens Company, to a new corporation to be organized for the purpose known as Florida West Coast Ice Com-

pany for cash sufficient to pay liabilities and for notes secured by first mortgage bonds. (Findings of Fact, R. 13-14.) "In October, 1926, the directors of petitioner and the Citizens Company met and unanimously approved the terms of the agreement with the National Corporation and at that time confirmed their prior agreements and understandings that the proceeds of the transfer would be distributed and the corporations dissolved." (Findings of Fact, R. 14.)

Pursuant to the plan, on November 4, 1926, separate contracts were made by Petitioner and Citizens Company with the National Public Service Corporation setting out the terms of the agreement with reference to the transfer of the assets. The performance of each of the contracts was dependent upon the performance of the other. Under Petitioner's contract it was to receive for its properties $400,000 in cash, which was the amount determined as necessary to discharge Petitioner's liabilities (Findings of Fact, R. 16) and $1,000,000 in 6% notes secured by bonds in turn secured by a mortgage on the properties transferred by Petitioner and Citizens Company. The properties were to be transferred free of all defects, liens and encumbrances. (Findings of Fact, R. 14-16.)

In December, 1926, National Public Service Corporation caused a new corporation to be formed known as the Florida West Coast Ice Company, for the purpose of carrying out the agreements with Petitioner and the Citizens Company. Thereafter, on December 17, 1926, representatives of Petitioner, Citizens Company, Florida West Coast Ice Company and creditors of Petitioner and Citizens Company met for the purpose of consummating the transaction. The properties of Petitioner and Citizens Company were transferred to Florida West Coast Ice Company. Approximately $226,000 was paid by the trans-

feree directly to creditors of Petitioner. $137,000 was paid to Petitioner, who, in turn, paid the balance of its liabilities. $33,000 had already been advanced to Petitioner for the express purpose of retiring its outstanding bonds. The balance of the consideration for the transfer, $1,000,000 face value of 6% notes secured by mortgage bonds, were delivered to Petitioner, which notes represented Petitioner's equity in the property transferred after payment of debts. The transfer of the property of Citizens Company was consummated at the same time in the same manner. (Findings of Fact, R. 17-19.)

On January 20, 1927, pursuant to the plan theretofore made, formal resolutions were passed for the winding up of the affairs of both Petitioner and Citizens Company, distribution of the assets and dissolution of the two corporations. The outstanding certificates of stock of Petitioner were surrendered to the company and remained in its custody. Distribution of all of the assets was promptly made except that a small amount of cash was retained as a contingent fund for possible expenses. (Findings of Fact, R. 18-19.)

Petitioner, in its income tax return for 1926, included no profit on this transfer, relying upon the fact that it was a party to a non-taxable reorganization within the meaning of Section 203. The Commissioner of Internal Revenue held that Petitioner was subject to tax. The Board of Tax Appeals approved the Commissioner's action on the ground that the transaction did not constitute an *exchange* within the meaning of Section 203 of the Revenue Act of 1926.

The Circuit Court of Appeals affirmed the Board of Tax Appeals on the ground that the acquisition of substantially all of the assets of one corporation by another

without stock control of the transferee by the transferor or its stockholders is not a reorganization within the meaning of the above statute (R. 28-31). Respondent admitted in its brief in opposition to the petition for certiorari, page 10, that this interpretation by the Circuit Court of Appeals is contrary to the construction of the statutory definition of "reorganization" by the Treasury Department.

Respondent's position has been that the transfer of the assets from Petitioner and Citizens Company to Florida West Coast Company was a sale as dinstinguished from an exchange largely because of the use of the words "sale," "vendor," and "purchaser" in the contracts, and that Section 203 (c) (1) did not apply to sales. Petitioner's position is that no such distinction is made in the statute, the only test being whether substantially all the properties of one corporation are transferred to another corporation for stock or securities.

Respondent contended below that at least the $400,000 cash payment which was used to pay creditors was subject to tax. Petitioner contends that this payment used to liquidate indebtedness was not taxable profit, was in fact distributed and further that the substance of the transaction was a transfer subject to liabilities and that Petitioner received only notes secured by mortgage bonds for its net assets.

Specification of Error to Be Urged.

(1) The Circuit Court of Appeals erred in failing to hold that the acquisition of substantially all of the properties of Petitioner by another corporation constituted a reorganization under Section 203 of the Revenue Act of 1926.

(2) The Circuit Court of Appeals erred in not holding that the acquisition of substantially all of the Petitioner's properties by another corporation in exchange for cash and securities and the distribution of the proceeds thereof was a transaction upon which gain was not recognizable to Petitioner pursuant to Section 203 of the Revenue Act of 1926.

(3) The Circuit Court of Appeals erred in failing to hold that the Board of Tax Appeals erred in including in Petitioner's taxable income for the year 1926 the amount of $552,144.12 as profit on the transfer of its properties to the Florida West Coast Ice Company.

Summary of Argument.

There was a reorganization within the meaning of the statute because substantially all, 99%, of Petitioner's properties were acquired by another corporation. The statute itself, for the purposes of the statute, defines reorganization as including "the acquisition by one corporation of * * * substantially all the properties of another corporation". The administrative construction of the statute has always given the language of the statute its literal meaning regardless of stock control or the receipt of any stock by the transferor or its stockholders. That accords with the legislative history and purpose of Section 203 of the Revenue Act.

There was a plan of reorganization and Petitioner was a party to the reorganization. The findings of fact state that everything was done pursuant to a plan. Petitioner was necessarily a party to the reorganization.

There was an exchange for securities and cash within the meaning of the statute. The word "exchange" in-

cludes sale. Congress did not use the term "barter." The legislative history shows that Congress and the Treasury Department used the terms "exchange" and "sale" interchangeably. The regulations of the Treasury Department interpreting the statute likewise use the terms interchangeably. Whether there was an exchange or not within the meaning of the statute depends upon the nature of what was received in return for Petitioner's property. The receipt of either securities or stock alone or with cash constitutes an exchange. Petitioner received securities in the form of notes secured by mortgage bonds.

To the extent that the transferor corporation retains the cash there may be a taxable profit. In this case Petitioner retained no cash but the cash was used for the payment of its debts. Liabilities must be paid before liquidation and distribution to stockholders. Whether the property is sold subject to debts or part of the proceeds used to pay the debts, the result is the same. In this case a substantial part of the debts, approximately $226,000, was paid directly by the transferee, the balance approximately $174,000 by Petitioner.

The purpose of Congress in enacting Section 203 was to relieve from double taxation where a corporation conveys substantially all of its assets, winds up its affairs, liquidates and dissolves. The statute imposes one tax, and that upon the stockholders.

ARGUMENT.

Introduction.

No question arises in this case as to the taxability of the profit derived by the stockholders of Petitioner upon the receipt by them of the proceeds received from the transferee. The Revenue Act of 1926 does not impose a tax upon the corporation in a transaction of this kind. It was the intention of Congress to avoid double tax,—one upon the corporation and one upon the stockholder, where the corporation disposes of substantially all of its properties for cash and securities and merely serves as a conduit for the distribution of such proceeds to its stockholders.

The legislative history and purpose of the statute should be kept in mind. The reorganization provisions of the 1924 and 1926 Acts which are retained in the 1928 and 1932 Acts were remedial and intended to eliminate double taxation. Prior to the Revenue Act of 1921, if a corporation transferred its assets to another corporation and distributed the proceeds received to its stockholders, a double tax resulted, one on the corporation and one on the stockholders. *Rockefeller* v. *United States*, 257 U. S. 176; *United States* v. *Phellis*, 257 U. S. 156; *Cullinan* v. *Walker*, 262 U. S. 134; *Appeal of Wallis Tractor Co.*, 3 B. T. A. 981.

If the same result were accomplished by the sale of all of the stock to another corporation and the assets thereafter liquidated to the purchasing corporation, there would be but one tax, and that on the stockholder. It was rec-

ognized that the double tax, where the corporation first disposed of its assets and distributed the proceeds, was not only a hardship and hampered business reorganization but was also a discrimination in favor of those who accomplished the same result in another manner.

The 1921 Act provided in Section 202 that in any corporate reorganization, no gain or loss should result from the exchange of securities. The Report of the Committee on Finance of the United States Senate, in referring to the changes made by the Revenue Act of 1921, in connection with the tax upon exchanges of property, said:

> "Probably no part of the present income tax law has been productive of so much uncertainty or has more seriously interfered with necessary business readjustment. * * *
>
> "The preceding amendments, if adopted, will, by removing a source of grave uncertainty and by eliminating many technical constructions which are economically unsound, not only permit business to go forward with the readjustments required by existing conditions, but also will considerably increase the revenue by preventing the taxpayers from taking colorable losses in wash sales and other fictitious exchanges."

The provisions of the 1921 Act, however, were still found to be inadequate to accomplish the full result desired, and in Section 203 of the Revenue Act of 1924 the provisions of the 1921 Act were still further liberalized. In the "Statement of the Changes Made in the Revenue Act of 1921 by H. R. 6715 (Revenue Act of 1924) and the Reasons Therefor," prepared by the Treasury Department for the

use of the Committee on Finance of the United States Senate, it is said:

"A corporation in connection with a reorganization may dispose of its assets in one of three ways: It may transfer them to a new corporation in exchange for stock *or* cash; it may transfer them to the new corporation, the consideration being the payment by the new corporation of stock *or* cash to the stockholders of the old corporation; or the new corporation may buy, with its stock and cash, from the stockholders of the old corporation, their stock, and then liquidate the old corporation. If a corporation adopts the first method, its gain from the sale could be taxed. If it adopts the second method, the gain probably could be taxed on the theory of constructive receipt by the selling corporation. If it adopts the third method, there is no theory on which any gain to the old corporation could be taxed. *As a result of these considerations, subdivision (c) has been so drafted that the tax liability on the selling corporation is the same no matter which of the three methods set out above is adopted.* In others words, *if the selling corporation is a mere conduit* through which the consideration for the sale of the assets passes, or if the consideration for the sale of the assets is paid direct to the stockholders of the old corporation, without passing through the conduit, no gain or loss to the old corporation is recognized, *and the same result is reached that would have to be reached necessarily if the transaction were accomplished through the medium of a purchase by the new corporation of the stock of the old corporation, followed by a liquidation of the old.*" (Italics supplied.)

The Committee on Ways and Means, in recommending the passage of the Bill, said, in referring to Section 203 (e) of the 1924 Act:

> **"In other words, if the corporation which sells its assets in connection with the reorganization acts merely as a conduit in passing the proceeds of the sale on to its stockholders, no gain to the corporation is to be recognized, * * *." (Report No. 179, 68th Congress.)**

The Report of the Finance Committee of the Senate (Report No. 398, 68th Congress) contained identical language to that contained in the Report of the Ways and Means Committee of the House of Representatives.

The provisions of the Revenue Act of 1926 in this connection are substantially identical with those of the Revenue Act of 1924.

The transaction in the case at bar is exactly such a one as the Treasury Department, the Ways and Means Committee of the House and the Finance Committee of the Senate state that they intended to relieve from double taxation.

* * *

The facts in this case show that the transaction was a reorganization within the meaning of Section 203 of the Revenue Act of 1926, resulting in no tax to Petitioner:

(1) The transfer of substantially all of Petitioner's assets to another corporation constitutes a reorganization within the meaning of the statute.

(2) There was a plan of reorganization pursuant to which all steps in the transaction were taken, and Petitioner was a party to the reorganization.

(3) There was an exchange of assets for securities and cash within the meaning of Section 203 (e) (1) of the Revenue Act of 1926.

(4) The notes received by Petitioner, secured by bonds which in turn were secured by a mortgage on the properties of the transferee, were securities within the meaning of Section 203 of the Revenue Act of 1926.

(5) The fact that $400,000 of the proceeds was used in the payment of the debts of Petitioner does not make that amount taxable income to Petitioner.

These points will be discussed in the above order.

I.

The acquisition of substantially all of petitioner's assets by another corporation was a reorganization under Section 203 of the Revenue Act of 1926.

Section 203 (h) (1) provides:

> "(1) The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected."

A new corporation, Florida West Coast Ice Company, was organized and acquired all of the operating assets of

two corporations, Petitioner and Citizens Company. The property so acquired from Petitioner was 99% of its total property. Substantially all of the property of Citizens Company was likewise acquired by the Florida West Coast Company. The balance of the property of Petitioner and the Citizens Company was conveyed to a fourth corporation as trustee for the stockholders. Dissolution proceedings for both Petitioner and the Citizens Company were instituted, their debts paid, their affairs wound up, and the two corporations were dissolved. (R. 18-19.)

There was a reorganization, therefore, within the express definition of the statute. The Circuit Court of Appeals held that there was no reorganization because it stated the term "reorganization" as ordinarily defined requires a continuance of stock control of the transferee by the transferor or its stockholders.

The wording of the statute permits no such construction. Where a statute defines its terms, such definitions control and resort to definitions outside the statute are unnecessary. There have been many definitions of "reorganization," both statutory and otherwise. As stated in *National Pipe & Foundry Co.* v. *Commissioner*, 19 B. T. A. 242, 250, "Under the 1926 Act the statute specifically states that a reorganization shall include the acquisition of substantially all the assets of another corporation. Definitions of a reorganization or what a reorganization might be in the absence of the definition in the statute do not have the effect of changing what the statute specifically provides shall be included in a reorganization."

The statutory definition of "reorganization" is purposely very broad. It includes recapitalization, mere change in identity, form or place of organization, acquisition of all the property of one corporation by another

corporation, acquisition by one corporatoin of a majority of the stock of another corporation, a merger or consolidation "however effected". In this case we have, pursuant to a plan, not only the acquisition by one corporation of substantially all of the property of another corporation, but we have, in addition, the acquisition by one corporation of substantially all the property of two corporations and the dissolution of the transferor corporations. These facts constitute a reorganization. The words "reorganization", "consolidation" and "merger" have no definite crystalized meanings. They must be defined in connection with the particular statute or document in which they are used. The context and the purpose sought to be accomplished determine the meaning of the words in each particular case. Courts have variously defined the terms,—some broad and some narrow—but such definitions are valueless in the absence of the particular statute or document under consideration.

> "The term (Reorganization) * * * has no very definite meaning in the law of corporations, but is applied indifferently to various proceedings and transactions by which succession of corporations is brought about, and also to proceedings by which existing corporations are continued under a different organization without the creation of a new corporation." *Fletcher Cyclopedia Corporations*, Volume 7, page 8465.
>
> "There is no magic in the use of the word 'consolidation' to effect that result. If the coming together of two corporations under the authority of law be in fact consolidation, it is of no consequence by what name the act is characterized; nor is it of any consequence by what steps the result has been effected. One of those steps may take the shape of bargain and sale." *Capital Traction Company* v. *Offutt*, 17 App. D. C. 292.

> "Much is said in the argument about the terms 'merger' and 'consolidation,' and distinctions are sought to be drawn between the two forms of contract. We do not attach great importance to this line of argument. While there appears to be a distinction recognized by most of the authorities between a 'merger,' strictly speaking, and a 'consolidation,' still the terms are not always used with strict accuracy. Besides, the agreement under consideration employs both terms, so that the true intent of the agreement cannot be determined by recourse to the dictionaries." *C. & E. I. R. R. Co.* v. *Doyle,* 256 Ill. 514, 522.

Congress in this section has used the word "reorganization" in a broad, generic and all-inclusive sense to accomplish a definitely expressed purpose. The restricted, narrow construction of this term adopted by the Circuit Court of Appeals defeats the purpose of Section 203.

The effect of the decision of the Circuit Court of Appeals is to exclude from the operation of Section 203 all cases where the transferor or its stockholders do not become stockholders of one transferee. But Section 203 applies to transfers either for stock *or* securities.

> "203 * * *(b) * * *(3) No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock *or* securities in another corporation a party to the reorganization." (Italics supplied.)
>
> "203 * * * (e) If an exchange would be within the provisions of Paragraph (3) of Subdivision (b) if it were not for the fact that the property received in exchange consists not only of stock *or* securities permitted by such paragraph to be received without the

recognition of gain, but also of other property or money, then—

"(1) if the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, * * * ." (Italics supplied.)

A reference to the definition of a reorganization in the statute, Section 203 (h) (1), will show that the requirement of control or stock ownership in the transferor applies only to subdivision (B), which provides that where one corporation acquires only part of the assets of another corporation, there must be an ownership of 80% of the stock by the transferor, or its stockholders. There is no stock requirement whatever where one corporation acquires substantially all the properties of another corporation as set out in subdivision (A). There is absolutely nothing requiring any element of control by the transferor or its stockholders, and, as stated, such a contention is completely negatived by the previous provisions of Section 203 which provide that *either* stock *or* securities may be received without subjecting the transferor to a tax.

Stock ownership is not essential. Securities are sufficient. The definition of "reorganization" applied by the Circuit Court of Appeals in this case defeats the purpose of Congress to eliminate double taxation in cases where a corporation disposes of substantially all of its properties and distributes the proceeds to its stockholders. The statute is designed to avoid a tax on both the dissolving corporation, which serves merely as a conduit, and on its stockholders. Further, the legislation was designed to remove what was otherwise a determent to normal business reorganization and eliminate the previous discrimination between the case where substantially all the assets of one

corporation are acquired by another and the proceeds distributed to the stockholders, and the case where the stock of one corporation is purchased by another and the assets of the old corporation then obtained by liquidation.

In the "Statement of Changes Made in the Revenue Act of 1921 by H. R. 6715 (Revenue Act of 1924) and the Reasons Therefor", prepared by the Treasury Department for the use of the Committee on Finance of the United States Senate hereinabove quoted from on page 13, it is stated that a corporation in connection with a reorganization could dispose of its assets in one of three ways: (1) It could transfer the assets to a new corporation in exchange for stock or cash; (2) it could transfer the assets in consideration of stock or cash being paid to the stockholders of the old corporation; or (3) the new corporation could buy the stockholders' stock for stock and cash and then liquidate the old corporation. The statement then goes on to point out that under the first method the gain to the corporation would be taxed and that under the second method the gain probably could be taxed on the theory of constructive receipt by the selling corporation, but that under the third method there could be no tax to the old corporation. The statement then goes on to say that Subdivision (e) of the Revenue Act of 1924, then before Congress for consideration, had been so drafted that the tax liability on the selling corporation would be the same no matter which of the three methods set out above was adopted and states:

> " * * * *if the selling corporation is a mere conduit* through which the consideration for the sale of the assets passes, or if the consideration for the sale of the assets is paid direct to the stockholders of the old corporation, without passing through the conduit, no gain or loss to the old corporation is recognized * * *."

As above stated at page 14, the reports of the Finance Committee of the Senate and the Ways and Means Committee of the House used almost identical language.

From the foregoing, it clearly appears that Section 203 (e) was intended to protect against double taxation of corporation and stockholders where, as part of the reorganization, the corporation disposes of its assets, distributes the proceeds and goes out of business. Under such circumstances, the stockholders are taxable but the corporation acts as a mere conduit and it was the intention of Congress that no tax be imposed upon the corporation.

The Regulations of the Treasury Department recognize that under the statute, the simple acquisition of substantially all of the assets of one corporation by another is a "reorganization" and that it is not necessary that the transferor corporation receive for its properties stock control of the transferee or, for that matter, any stock of the transferee. Article 1574 of Regulations 69 under the Revenue Act of 1926 provides, in part, as follows:

> "If two or more corporations reorganize, for example, by—
>
> "(1) the dissolution of corporation B and the sale of its assets to Corporation A,
>
> "(2) the sale of its property by B to A,
>
> "(3) the sale of the stock of B to A,
>
> "(4) the merger of B into A,
>
> "(5) the consolidation of A and B,
>
> "(6) the acquisition by A of a majority of the voting stock and a majority of the total number of shares of all other classes of stock of B or of substantially all of the properties of B, or

"(7) the transfer by A of all or part of its assets to B where immediately after the transfer A or its shareholders are in control of B,

then no taxable income is received from the transaction by corporation A or B if the sole consideration for the transfer of the assets is stock or securities of corporation A or B; * * * ."

Article 1575 provides as follows:

"If, in pursuance of a plan of reorganization, property is exchanged by a corporation a party to a reorganization for stock or securities in another corporation a party to the reorganization and other property or money, then, if the other property or money received by the corporation is distributed by it pursuant to the plan of reorganization, no gain to the corporation will be recognized."

Article 1574 further states:

"Adequate provision is made in the statute for cases in which income is actually realized by the shareholders in connection with the reorganization through the receipt of cash or property other than the stock of a corporation a party to the reorganization. (See art. 1575)"

Articles 1574 and 1575 of Regulations 65 under the Revenue Act of 1924 are practically identical.

It will thus be seen that the regulations of the Treasury Department are in accordance with the expressed purpose of Congress in enacting the legislation and in accordance with what seems to us the clear language of the definition of reorganization in Section 203 (h) (1). If, as pointed out in Example 7 in the Regulations, only a part of the

assets are transferred, the transferor or its stockholders must maintain a stock control. If, on the other hand, substantially all of the assets are sold, as pointed out in Example 2, there is no requirement for any stock ownership in the transferee. Likewise, there is no requirement of stock ownership in Example 1. It makes no difference whatever whether the transaction comes within what the Circuit Court of Appeals referred to as "ordinary" definitions.

The Commissioner of Internal Revenue has repeatedly ruled that the simple acquisition of substantially all of the property of one corporation by another is a reorganization under this provision of the statute. There was corporate stock involved in some of these rulings, in one case, some preferred stock and no common, but in no case is there any suggestion of control or of any particular percentage of stock. The General Counsel of the Bureau held in each case that there was a reorganization by reason of the acquisition of substantially all of the assets of a corporation.

In *G. C. M. 3827*, VII-2, C. B., 114, 1928, it was said (p. 115):

> "It is noted that the O Company acquired all of the properties of the taxpayer company, and hence the transaction was a 'reorganziation' within the express terms of the definition contained in section 203 (h) (1) * * *." (Revenue Act of 1926.)

In *G. C. M. 7472*, IX-1, C. B., 184, 1930, it was said (p. 188):

> "It is clear that the transfer on ....., 1926, by the M Company of all of its assets to the N Company, constituted 'the acquisition by one corporation of * * * substantially all the properties of another

corporation', and hence a 'reorganization' within the meaning of section 203 (h) (1) (A) of the Revenue Act of 1926."

In *I. T. 2542*, IX-2, C. B. 126, 1930, it was said (p. 127):

"In carrying out such plan, the M Company acquired the 10 Y shares of stock of the N Company, which constituted substantially all the assets of the O Company. This transaction was a corporate reorganization within the meaning of section 112 (i) of the Act * * * ." (Revenue Act of 1928).

In *G. C. M. 8565*, IX-2, C. B., 127, 1930, the General Counsel quoted from a discussion in the Senate in connection with the adoption of the Revenue Act of 1921, where, in discussing the following language:

"A majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or of substantially all of the properties of another corporation * * * "

Senator Simmons said:

"That is in the disjunctive, 'or of substantially all of the properties', * * * ."

In Respondent's brief in opposition to the Petition for Certiorari, it is stated at page 10:

"We are informed that the consistent administrative construction of Section 203 (h) (1) (A) by the Treasury Department has always been that the acquisition of substantially all the property of a corporation is a 'reorganization' within the meaning of the statute, provided the other conditions of the statute are met. We are also informed by the Treasury Department that in thus construing the statute it has attempted to give proper effect to the parenthetical

clause in Section 203 (h) (1) (A) and, therefore, has not been and is not restricting the meaning of Section 203 (h) (1) (A) in accordance with the conclusion of the court below, in so far as it may be regarded as giving no effect to the parenthetical clause."

In *National Pipe & Foundry Co.* v. *Commissioner*, 19 B. T. A. 242 the Board of Tax Appeals said (p. 250):

"Under the definition of a reorganization as contained in paragraph 203 (h) (1) (A), the acquisition of substantially all the property of one corporation by another is a reorganization. * * *."

In *Green* v. *Commissioner*, 24 B. T. A. 719, the Board, at page 725, quoted the following language from G. C. M. 1753 (C. B. VI-1, p. 138),

"For example, a transfer of all the assets of a corporation constitutes a reorganization under the second part of definition (A) irrespective of the element of eighty per cent control demanded by definition (B)."

See also *Tulsa Oxygen Co.* v. *Commissioner*, 18 B. T. A. 1283.

Williams v. *Commissioner*, 44 Fed. (2d) 467, decided by the Circuit Court of Appeals for the Eighth Circuit on October 10, 1930, is squarely contrary to the decision below. That case also arose under the Revenue Act of 1926. It appeared that the new Alberni-Pacific Company purchased all the stock of the old Alberni-Pacific Company in consideration of bonds and cash of the new company. The properties of the old company were transferred to the new company. Neither the old corporation nor its stockholders received any stock in the new corporation. The

Circuit Court of Appeals for the Eighth Circuit held that there was a reorganization on which neither gain nor loss would be recognized under the Revenue Act of 1926.

In *Prairie Oil & Gas Company* v. *Motter, Collector*, decided September 17, 1932 by the United States District Court for the District of Kansas, Second Division, not yet reported but published in Commerce Clearing House Income Tax Service for 1932 at paragraph 9498, it was held over the objection of the taxpayer that there was a reorganization under Section 203 (h) (1) of the Revenue Act of 1926 where a corporation purchased the stock of another corporation and obtained its assets through the dissolution of such other corporation, though the only consideration given by the acquiring corporation was cash. Neither the transferor nor its stockholders received any stock of the acquiring corporation. The court stated:

> "The whole question appears to turn on whether or not the parenthetical clause in Section 203 (h) (1) (A) is a clause of limitation or a clause of enlargement. It is strongly argued by plaintiff that the transaction would not fall within the term 'merger' or 'consolidation' as used in the ordinary sense because there was no exchange of stock, and that neither the term 'reorganization' or its explanatory terms 'merger' or 'consolidation' are broadened or added to by the addition of the parenthetical clause. Where the legislature expresses the meaning of a word or term within a tax statute, that meaning must be given to such a word or term by the courts. Congress may so define words as to extend their ordinary meaning. I am of opinion the meaning which Congress intended to give this parenthetical clause must largely turn upon the construction of the word 'including' which preceded it. 'Including' is a word of enlargement rather than a

word of limitation. Oxford's English Dictionary describes 'including' as a present participle which often governs the subject, and used in the same sense as 'inclusive of.'

"In *In re Goetz's Will*, 75 N. Y. Supp. 750-751, it is stated that ' "including" is not a word of limitation rather it is a word of enlargement and in ordinary signification implies that something else has been given beyond the general language which precedes it.'

"The only reasonable construction therefore which can be given Section 203 (h) (1), is that the term 'reorganization' means a merger or consolidation, which in addition to their ordinary meaning includes situations where one corporation acquires at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation or substantially all of the properties of another corporation. Under the facts in this case the plaintiff did acquire all of the stock of the Olean Petroleum Company and did acquire substantially all of the properties of the Olean Petroleum Company. It did, in fact, acquire all of the physical properties of the Olean Petroleum Company."

In *Cortland Specialty Company* v. *Burnet*, 60 F. (2d) 937, the Circuit Court of Appeals for the Second Circuit appears to have followed the Circuit Court of Appeals for the Fifth Circuit in the case at bar in holding that there must be a continuance of interest in order to constitute a reorganization. The Board of Tax Appeals, in a recent opinion, *Warner Company* v. *Commissioner*, 26 B. T. A. ....., promulgated October 19, 1932, Commerce Clear-

ing House Dec. No. 7776, cites and follows the opinion in the *Pinellas* case below and the *Cortland* case on this point. We think we have demonstrated that these decisions are clearly erroneous in requiring a continuity of interest. Ownership of stock is not a requisite to a reorganization within the meaning of the statute.

The interpretation by the Committees of Congress was necessarily prior to the enactment of the legislation. Regulations 65, under the Revenue Act of 1924, were promulgated prior to the enactment of the Revenue Act of 1926. Regulations 69 were promulgated prior to the enactment of the Revenue Act of 1928. Many of the rulings by the Bureau and decisions by the Board of Tax Appeals were prior to the re-enactment of the same provisions in subsequent statutes. The re-enactment of the legislation by Congress in the light of such interpretation should be held an adoption by Congress of that interpretation. *Komada* v. *United States,* 215 U. S. 392; *United States* v. *Cerecedo Hermanos* v. *Compania,* 209 U. S. 337, *Commonwealth Commercial State Bank* v. *Lucas,* 41 Fed. (2d) 111, in which the leading cases are cited and discussed.

If, in order to constitute a reorganization, Petitioner must have maintained a stock control or interest in the new company, then those parts of subdivisions (b) and (e) of section 203 which provide that the receipt of "securities" is sufficient to constitute a non-taxable transfer are wholly ineffective and the efforts of Congress and the Treasury Department to relieve from double taxation in such a case have been futile.

II.

There was a reorganization plan and petitioner was a party to the reorganization.

The Board of Tax Appeals found as a fact that there was a plan to dispose of the properties, dissolve the corporations and distribute the proceeds to the stockholders, all of which was carried out. (R. 19). Since there was a reorganization and since the details of the reorganization were worked out and agreed upon prior to the transfer of the assets of the Petitioner it necessarily follows that there was a "plan of reorganization". Petitioner was a party to the reorganization because Petitioner was a necessary participant in what took place. The decisions in the Board of Tax Appeals and the Bureau of Internal Revenue are uniformly to this effect.

In G. C. M. 3827, VII-2 C. B., 1928, page 114, the General Counsel of the Bureau of Internal Revenue discusses a situation where the properties of the M Company were transferred to the O Company in exchange for cash and shares of that company's preferred stock. The outstanding preferred stock of the M Company was then retired, the cash received from the O Company being used for this purpose. The expenses of dissolution were met out of the proceeds of the sale of shares of the O Company preferred stock. The M Company then distributed to its common stockholders the remaining shares of the O Company preferred stock acquired in the reorganization and formally dissolved. The M Company's status in the plan was identical with that of petitioner. The General Counsel stated:

> "It is the opinion of this office that the taxpayer company (the M Company) was a party to such reorganization." (Matter in parentheses added.)

See also, *First National Bank of Champlain* v. *Commissioner,* 21 B. T. A. 415; *Tulsa Oxygen Co.* v. *Commissioner,* 18 B. T. A. 1283; *National Pipe & Foundry Company* v. *Commissioner,* 19 B. T. A. 242; G. C. M. 7472, C. B. IX-1, page 184, 190; I. T. 2542, C. B. IX-2, p. 126.

III.

There was an exchange of assets for securities and cash within the meaning of Section 203(e)(1) of the Revenue Act of 1926.

The Board of Tax Appeals held that the transaction here in question constituted a *sale* as distinguished from an *exchange* and that therefore Section 203 (e) (1) was not applicable, although the Board, in its Findings of Fact described the transaction as an "exchange" of assets for cash and notes. (R. 19.)

There is no warrant in the statute or in reason for any such distinction. In fact the words "sale" and "exchange" are not mutually exclusive. Every sale is an exchange although every exchange may not be a sale. Exchanges are not limited to barters but include exchanges for money or currency. In fact money is largely a medium of exchange. However this may be as a general proposition, Congress included in Section 203 all transfers of property for which stock or securities were received in whole or in part. The words "sale" and "exchange" were used interchangeably by the Treasury Department in recommending the legislation, by the Ways and Means Committee of the House, by the Finance Committee of the Senate and by the Treasury Department in its Regulations defining and administering the statute. The form of the transfer of the assets is wholly immaterial. The dis-

tinction made by the Board of Tax Appeals merely results in defeating in large part the purpose of the statute without the slightest warrant in the language of Congress and contrary to its express purpose.

In the "Statement of Changes Made in the Revenue Act of 1921 by H. R. 6715 and the Reasons Therefor", hereinabove quoted at page 13, the expression "selling corporation", "consideration for sale" and "purchase by the new corporation" are used to explain the "exchanges" or non-taxable transactions under Section 203 of the Revenue Act of 1924, which is identical with Section 203 of the Revenue Act of 1926. The Report of the Finance Committee of the Senate was identical with the Report of the Ways and Means Committee of the House, hereinabove quoted at page 14, and it will be observed that those two committees used the expressions "proceeds of the sale" and "corporation which sells its assets in connection with the reorganization" in explaining the non-taxable transfers of property provided for in Section 203.

The Regulations of the Treasury Department also use the term "sale" in describing non-taxable reorganization. Article 1574 of Regulations 65 under the Revenue Act of 1924 reads in part as follows:

> "If two or more corporations reorganize, for example, by either (1) the dissolution of corporation B and the *sale* of its assets to corporation A, or (2) *the sale of its properties by B to A*, or (3) the *sale* of the stock of B to A, or (4) the merger of B into A, or (5) the consolidation of A and B, or (6) the acquisition by A of a majority of the voting stock and a majority of the total number of shares of all other classes of stock of B or of substantially all of the properties of B, or (7) the transfer by A of all or part of its assets to B where immediately after the

transfer A or its shareholders are in control of B, * * *". (Italics supplied)

Article 1574 of Regulations 69 under the Revenue Act of 1926 hereinabove set out at pages 21, 22, is substantially identical. The word "exchange" is not used in any of the examples of a non-taxable reorganization, but the word "sale" is repeatedly used.

In *Appeal of Rodenbough, Executor,* 1 B. T. A. 477, 25 Fed. (2d) 13, it was held that the word "exchange" as used in the Revenue Act of 1918 included an outright sale of the property and the reinvestment of the proceeds in other property. The case related to the interpretation of the provision of the Federal Estate Tax Act which provides that there shall be deducted in determining the principal of the gross estate an amount equal to the value of any property which can be identified as having been received by the decedent as a share in the estate of any person who died within five years prior to the death of the decedent or which can be identified as having been acquired by the decedent in "exchange" for property so received, if an estate tax was collected from such preceding esate. It was held both by the Board of Tax Appeals and the Circuit Court of Appeals that securities which had been purchased with the proceeds of the sale of the securities received from a preceding estate were acquired in *exchange* for the original property within the meaning of the Revenue Act. The Court said (p. 15):

> "A statute must be read in the light of its purpose. *Tucker* v. *Alexander,* 275 U. S. ....., (228), 48 S. Ct. 45, 72 L. Ed.—as it is clear that the Congress intended completely to avoid the inequity of double taxation, we shall, in order to effectuate its intention, give the statute a construction as broad as the intention itself."

Transfers of property for cash and notes are exchanges.

In *Appeal of Somers Lumber Company*, 2 B. T. A. 106, the taxpayer sold a hotel, receiving therefor $25,075.38 in cash and a second mortgage in the amount of $65,000. The Board said in its opinion (p. 108):

> "In the instant case the taxpayer received in exchange for its property a mixed consideration of cash and other property,"

and in holding the transaction taxable, the Board cited Section 202 (b) of the Revenue Act of 1918, which provides that "when property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; * * *."

In the *Appeal of J. S. Cullinan*, 5 B. T. A. 996, the petitioner transferred real estate and received in payment cash and vendor's lien notes. The Board, in its opinion, applied Section 202 (b) of the Revenue Act of 1918, dealing with exchanges.

In *Appeal of Anton M. Meyer*, 3 B. T. A. 1329, the taxpayer sold his interest in a partnership for $100,000 in cash and $175,000 in notes executed by the purchaser. The Board in this case held he came within Section 202 (c) of the Revenue Act of 1921, which provides that "where property is exchanged for other property which has no readily realizable market value, together with money or other property which has a readily realizable market value, then the money or the fair market value of the property having such readily realizable market value received in exchange shall be applied against and reduce the basis, provided in this section, of the property exchanged, and if in excess of such basis, shall be taxable to the extent of the excess; * * *."

In *Ed Foster* v. *Commissioner*, 19 B. T. A. 958, the petitioner transferred certain oil leases for $55,000, receiving one-half in cash and the remainder in an unsecured promissory note. The Board cited Section 202 (b) of the Revenue Act of 1918, above quoted, and stated, (p. 961) "The note in question was property received in exchange for other property within the meaning of the above statute. * * *"

In *Charles A. Rusk, et al.* v. *Commissioner*, 20 B. T. A. 138, the taxpayer sold certain real estate for $250,000, receiving a cash payment of $30,000, the balance of the purchase price being represented by promissory notes of the purchaser secured by a mortgage on the property. The Board, in holding that the transaction was subject to tax, cites Section 202 (c) of the Revenue Act of 1921, which provides the method for computing gain or loss "where property is exchanged for other property."

In *William Parris* v. *Commissioner*, 20 B. T. A. 320, the taxpayer had sold a certain royalty interest for cash and a promissory note. The Board applied Section 202 (b) of the Revenue Act of 1918, which deals with the exchange of property.

We again call attention to the fact that the words "exchange" and "sale" were used interchangeably by the Treasury Department in recommending the legislation, by the Ways and Means Committee of the House and by the Finance Committee of the Senate, that the Treasury Department, in its regulations in construing the particular sections of the 1924 and 1926 Acts, included sales, the rulings of the Board of Tax Appeals, in construing the word "exchange," included transactions identical with the one in this case, and that from time to time after such constructions, Congress re-enacted the identical language

in the Revenue Act of 1926, the Revenue Act of 1928 and the Revenue Act of 1932.

In this case, the transfer of the assets of Petitioner and the Citizens Company was in exchange for cash (all of which went to creditors) and securities. The statute specifically includes the transfer of substantially all of the properties of a corporation for securities and money.

IV.

Notes secured by bonds in turn secured by mortgages on the properties of the maker of the notes are securities.

Securities are something given to secure the payment of money. Probably the most common kind of security is a written promise to pay money secured by some kind of collateral. Respondent has suggested that the notes in this case are not securities because they were merely evidence of the additional amounts due. They not only evidenced an amount due but by reason of the collateral bonds and mortgage *secured* the additional amount due. Every bond, every note, every mortgage, every indenture is given to evidence an agreement to pay and to secure the payment of money at some future time. If one were asked for an example of the term "securities", probably the first example, and the one most likely to be acquiesced in by everyone, would be notes secured by mortgages or, as in this case, notes secured by first mortgage bonds. The Answer of the Commissioner of Internal Revenue, filed by the General Counsel of the Bureau of Internal Revenue, to the Amended Petition to the Board of Tax Appeals, stated that the Respondent "admits that all of the assets of the Petitioner, including ice and cold storage plants, machinery, equipment and certain real estate, were

disposed of during 1926, and that the Petitioner received therefor $400,000 in cash and $1,000,000 in *securities* of the Florida West Coast Ice Company." (R. 11) (Italics ours). It is true that at the hearing before the Board an Amended Answer was filed which did not contain the above admission.

In *Cortland Specialty Company* v. *Commissioner*, 60 Fed. (2d) 937, Circuit Judge Augustus N. Hand intimated that unsecured notes were not securities. We think this intimation is clearly wrong, but it should be borne in mind that in the case at bar the notes were secured by bonds and mortgages on the property of the obligor.

In G. C. M. 2000, VI-2 C. B. 248, the General Counsel held that promissory notes secured by a mortgage constituted securities within the meaning of the Revenue Act, stating at page 250:

> "Bills of exchange, bonds for the payment of money, and promissory notes are in the popular acceptance of the term 'securities' for money. (*Jennings* v. *Davis*, 31 Conn. 134; *Bank of Commerce* v. *Hart*, 37 Neb. 197, 55 N. W. 631.) In *Wagner* v. *Scherer* (85 N. Y. Supp., 894), the Supreme Court of New York (Appellate Division) had before it the question whether a promissory note was a security within the meaning of the New York statute involved, and in rendering its opinion the court stated in part as follows:
>
> > "'In popular acceptation the term "securities" includes promissory notes. (Anderson's Dictionary of Law, page 931.) "Promissory notes, among our people, are regarded as securities for money, more or less valuable; indeed, in proportion as the pecuniary ability and credit of the makers of them, are more or less reliable." (*Jen-*

ings v. *Davis*, 31 Conn. 134, 140.) Under the charter of a bank empowering it to "purchase securities of every kind" it has been held that the term "securities" as therein used meant notes, bills of exchange, and bonds; in other words, evidences of debt, promises to pay money. (*Bank of Commerce* v. *Hart*, 37 Neb. 197, 202, 55 N. W. 631, 20 L. R. A. 780, 40 Am. St. Rep. 479.) But the term "securities" embraces promissory notes not only in a popular sense, but in a legal sense as well. This was expressly held by Lord Chancellor Sugden in the case of *Barry* v. *Harding* (1 Jones & Latouche, 475, 483.)'

* * *

"* * * the word 'securities' as used in section 213 (b) 4 of the Revenue Act of 1921 includes not only the farm loan bonds issued by the joint stock land banks but also the first mortgage notes issued by the farmers and payable to these banks."

To the same effect see *First National Bank of Chicago* v. *United States*, 283 U. S. 142. There is no possible distinction between notes secured by a mortgage and notes secured by mortgage bonds.

In G. C. M. 3291 C. B. VII-1, p. 203, the stock of another corporation was acquired in consideration for the acquiring corporation's own stock and its debenture notes payable three months after date. The General Counsel held these debenture notes were securities of a corporation within the meaning of Section 202 of the Revenue Act of 1921, saying, page 204:

"It is apparent that these debenture notes were in fact securities of the O company and were not cash or the equivalent of cash.

> **"It must be concluded that * * * the stockholders of the M company received in place of their stock in that company stock *and securities* in a new company which was a party to a reorganization." (Italics supplied.)**

In *Rosenthal* v. *Brown*, 247 N. Y. 479, 481; 160 N. E. 921, the court said:

> "The word 'securities' in its broadest sense, includes not only bonds and other promises to pay money but also evidences of property such as corporate stocks."

In *J. S. Lang Engineering Company* v. *Commonwealth*, 231 Mass. 367, 371; 120 N. E. 843, the court said:

> "'In its ordinary acceptation the word "securities" includes bonds, certificates of stock or of deposit, notes, bills of exchange and other evidences of indebtedness or of property, and not mere choses in action.'"

See, also, *Mitchell* v. *Porter* (Tex. Civ. A.), 194 S. W. 981, 985; *Will of Stark*, 149 Wis. 631, 657; 134 N. W. 389; *Whitely* v. *Arbogast*, 17 Ohio Dec. 569, 574; *Peaslee* v. *Rounds*, 77 N. H. 544, 547; 94 Atl. 263; *Bank of Commerce* v. *Hart*, 37 Neb. 197, 202; 55 N. W. 631; *Boston Railroad Holding Company* v. *Commonwealth*, 215 Mass. 493, 496, 497; 102 N. E. 650.

The dictionaries, including the law dictionaries, commonly define "securities" as including evidences of debt, such as notes.

The fact that notes are short term notes does not affect their character as securities was held in *Harriman National Bank* v. *Commissioner of Internal Revenue*, 43 Fed.

(2d) 950, 952. The length of time until the maturity of the security is of no importance. Is there any question that ninety day notes issued by the Treasury Department are securities?

It can make no difference that the transfer was stated to be for a total cash consideration of $1,400,000, $1,000,000 of which was represented by notes. If the entire consideration had been bonds or notes secured by bonds it would have been equally necessary to state the full consideration in terms of money. Even if the agreement did not state the consideration in dollars the bonds or notes would necessarily be stated in dollars. The Board of Tax Appeals held there was an exchange and reorganization in *National Pipe & Foundry Co.* v. *Commissioner*, 19 B. T. A. 242 where the total consideration was stated in dollars although part of the consideration was to be paid in preferred stock.

V.

The $400,000 Cash Used to Pay Petitioner's Debts May Not Be Considered as Taxable Income.

In the Court below, Respondent contended that inasmuch as $400,000 was paid to creditors and not distributed to stockholders, all of it was taxable profit. Section 203 (c) provides in part as follows:

> "(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but
>
> "(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in

excess of the sum of such money and the fair market value of such other property so received, which is not so distributed."

The proceeds of the transfer were distributed pursuant to the plan of reorganization, to creditors and to stockholders. It was a part of the agreement that Petitioner's debts should be paid and that the property be transferred free and clear of any encumbrance. $33,000 was advanced prior to the transfer of the property for the express purpose of retiring Petitioner's outstanding bonds (R. 17); $226,000 was paid directly by the acquiring corporation to creditors; $137,000 additional was paid to Petitioner, who, in turn, paid its notes at the bank and other liabilities (Findings of Fact, 17-18). The substance of the transaction in fact was that Petitioner received the secured notes for its equity in the properties. The cash was paid either directly to creditors or through petitioner to creditors. The effect was the same as though the property had been conveyed for $1,000,000 in 6% secured notes, subject to liabilities.

Even if the Petitioner had received the gross consideration without a requirement and understanding that it would pay its outstanding liabilities, it could not have distributed the gross proceeds to the stockholders without payment of its debts. The distribution to stockholders must be the distribution of the net proceeds; otherwise the statute is unworkable. Congress intended to relieve from double taxation where the proceeds of the transfer were properly distributed and not retained by the transferring corporation.

In *National Pipe & Foundry Company* v. *Commissioner*, 19 B. T. A. 242, a part of the proceeds of the sale was used by the transferor to pay its liabilities, but the transaction was held to be a non-taxable reorganization.

In General Counsel's Memorandum 3827, C. B. VII-2, page 114, the General Counsel of the Bureau of Internal Revenue held that part of the consideration received by a transferor might be used to pay expenses of dissolution without making any part of the proceeds of the reorganization taxable.

CONCLUSION.

We believe the proposition has been established that the transaction involved in this case constituted a reorganization within the definition of that term contained in Section 203(h)(1) of the Revenue Act of 1926 and that the decision of the Circuit Court of Appeals for the Fifth Circuit was erroneous; that in all other respects the transaction was one in which neither gain nor loss is recognized under the provisions of Section 203 of the Revenue Act of 1926, and that no income tax can be imposed upon the Petitioner.

It is submitted that the decision of the Circuit Court of Appeals for the Fifth Circuit should be reversed.

Respectfully submitted,

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APPENDIX.

Section 203 of the Revenue Act of 1926:

RECOGNITION OF GAIN OR LOSS FROM SALES AND EXCHANGES

Sec. 203. (a) Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 202, shall be recognized, except as hereinafter provided in this section.

(b) (1) No gain or loss shall be recognized if property held for productive use in trade or business or for investment not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment, or if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

(2) No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(3) No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(4) No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely

in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

(5) If property (as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation, or the threat or imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, or into money which is forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, no gain or loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended.

(c) If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

(d) (1) If an exchange would be within the provisions of paragraph (1), (2), or (4) of subdivision (b) if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph

to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

(e) If an exchange would be within the provisions of paragraph (3) of subdivision (b) if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

(f) If an exchange would be within the provisions of paragraph (1), (2), (3), or (4) of subdivision (b) if it were not for the fact that the property received in exchange consists not only of property permitted by such

paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

(g) The distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, of its stock or securities or stock or securities in a corporation a party to the reorganization, shall not be considered a distribution of earnings or profits within the meaning of subdivision (b) of section 201 for the purpose of determining the taxability of subsequent distributions by the corporation.

(h) As used in this section and sections 201 and 204—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(i) As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.